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Latin America Development under Chinese Investment Hegemony

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Abstract: The magnificent rise of China as a superpower in the contemporaneous international system and its increased integration with the global economy is having both direct and indirect effects on Latin American region. The aim of this paper is to identify the main features of Chinese investment in the region and give a descriptive analysis of the impacts it is having on the development of the region. The increase of China investment represents both opportunities and challenges for Latin American economies and suggests where these investments should be more concentrated, taking into consideration both continents and sectors. Lastly, the paper discusses the challenges policy makers in Latin America and China are facing.

Keywords: Latin America, China, Trade, Investment, Chinese Investment Hegemony

1. Introduction

China's rapid growth and increased openness over the past 30 year has led to its emergence as a key player in the global economy this century. China is now the second largest economy in the world with its GDP growth at 9 percent per annum over the last 30 years. China's involvement in Latin America marginally began from the late 1950-1760's. Engagement focuses on cultural diplomacy and more recent and comprehensive engagement of China in Latin America is characterized by pragmatic Chinese initiatives (Cheng 2006, Devlin 2008, Jiberto & Hogenboom, Hirst 2008, Li 2007, Tokatlian 2008). Indeed, Chinese economic penetration in Latin America has profoundly altered the economic and political relationships in the region. Since 2004, when President Hu Jintao visited Latin America, China appeared to be translating its growing economic power into global political influence. The economic relationship seems to be a perfect fit: China's furious urbanization is taking in Latin America's ample supplies of copper, iron ore and soybeans. China plays three major roles in Latin America: as a consumer of commodities; as an exporter of manufactured goods; and as a lender and investor. The region's importance to a rising China is underpinned by its resources: Latin America has the world's largest reserves of silver at 49%, copper at 44%, and tin at 33% of the global total. It also has at least 16% of the global oil reserves and the largest quantity of arable land in the world. Latin America holds China's primary resources in four countries: Argentina, Brazil, Chile and Peru which altogether account for 70% of the region's exports to China. According to the Economic Commission for Latin America and the Caribbean (ECLAC), agricultural products make up 30% of these exports, with about 65% in minerals and resources.

The three main risks for China's trade partners are natural resource dependency, currency overvaluation and the possibility of economic sectors becoming uncompetitive. China's loans to Latin America point out that China funds different project from the international financial institutions (IFIs) or its counterparts. China banks basically focus 87% of their loans on the mining, energy, infrastructure, and transport and housing sectors. China is improving infrastructure in Latin America in order to facilitate the exports of natural resources, as well as providing contract opportunities for many Chinese enterprises interested in investing in the region. In the midst of 2005 and 2011, China lent $33.7 billion for infrastructure and housing projects, compared with $4.4 billion from the Inter-American Development Bank and zero amounts from the World Bank. Aim of this paper is to identify the main features of Chinese Investment in the region and analysis of the impacts it is having on development of the region. The increase of China's investment represents both opportunities and challenges for Latin American economies and suggests where, in terms of both continents and sectors, these are concentrated. Lastly, the paper discusses the challenges policy makers in Latin America and China are facing.

2. Literature review

The increased competitiveness of China and its expanded presence in world markets is having a major impact on both developed and developing countries. While this has been extensively analyzed from the developed countries point of view (Cass et. al., 2003; Prasad, 2004), a decade ago trade between China and Latin America region was limited but this has changed remarkably in the midst of 1999 and 2004. China imports from Latin America increased seven-fold while its exports to the region more than tripled. Chinese firms has also begun to invest in the region and this accounted for almost half of Chinese overseas investment in 2004 (Funakushi and Loser, 2005, p.8). These growing economic links have been reflected politically with the visit of Chinese presidents to the region, Jiang Zemin's 2001 visit to Argentina, Brazil, Chile, Cuba, Uruguay, and Venezuela and his 2002 visit to Mexico; Hu Jintao's state visit in 2004 to Argentina, Brazil, Chile, Cuba, and Mexico in 2005, Costa Rica, Cuba, and Peru in 2008, and Brazil in 2010. Xi Jinping first visited the region as president June 6, 2013, stopping in Trinidad, Tobago, Costa Rica, and Mexico and meeting with eight Caribbean leaders and in July 2014 stopping Brazil, Argentina, Venezuela and Cuba putting an important milestone in the development of China-Latin America relations. Number of Latin American leaders has also been to Beijing. It is important to acknowledge that China is economically much more significant for Latin America than Latin America is for China.

China's deepening reintegration with the global economy began in the modern era with its ‚Open door' policy started from the late 1970s and accelerated with its accession to the World Trade Organization (WTO) in 2001. Studies of this process generally examine China in terms of its position in global trade flows (e.g., Lall and Albaladejo, 2004); its comparative advantage as a manufacturing location (e.g., Chen et al., 2002; Rowen, 2003); and in the volume, distribution and impacts of inbound FDI (e.g., Buckley et al., 2002; Buckley, 2004b). In contrast, understanding of a further dimension of this process –namely, the rise in Chinese outward direct investment (ODI) in Latin America region – remains very incomplete. One reason is the paucity of sufficiently disaggregated data to permit formal analysis of the forces shaping Chinese ODI. The result has been a preponderance of descriptive research on FDI trends (e.g., Taylor, 2002; Deng, 2003, 2004; Wong and Chan, 2003; Buckley et al., 2006). Using official data from UNCTAD (2006) concerned with China's investment in Latin America, this exploratory study overviews the forces driving Chinese ODI. The research focuses on Chinese investment in Latin America and the extent to which theoretical explanations of Chinese trade and investment can explain FDI. In order to properly understand Chinese investment, it is necessary to understand Chinese investment features, opportunities and challenges. Such understanding might be a consequence of the continued pursuit of national economic imperatives, for instance, state-owned enterprises (SOEs) employed as an instrument of policy. As a result, we find that Chinese ODI is indeed distinctive in certain respects that have implications for theory, mainly the findings for important political aspects, but that familiar explanations of FDI are relevant, too. We conclude by recommending and commenting on future research directions.

3. China and Latin America trade

China has been gaining ground as a source of imports for Latin America. There is a steady increase in the technological content of Latin America imports from China and China imports of mainly natural resources from Latin America. Today, China is the region's third-biggest trading partner after the United States and the European Union. China is an important source of imports for all economies in the region, and for many of them it is also an important export market: 23% of Chilean, 15% of Peruvian and 13% of Brazilian exports go to China. It is predicted that this trend will continue to grow in the immediate future and China will become the second-largest market for the region's exports by 2014 and China will become the second largest sources of imports by 2015, overtaking the European Union in both instances (ECLAC, 2010).

China's impact on Latin America trade covers three areas: as an exporter of manufactured goods to almost every country in the region; as a buyer of raw materials principally from South American countries. This is consistent with the patterns for international insertion in the region based on the different competitive advantages of the sub-regions. South American countries specialize in the extraction of natural resources and a certain amount of primary processing. For countries exporting raw materials, located mainly in South America, China's influence has been very positive. Between 2000 and 2007, the country was responsible for 63% of the growth in soybean oil consumption and 46% of the increase in demand for crude oil. By itself, the increased demand for copper from China compensated the fall in the rest of the world. This upswing in global demand, led by China, has improved the terms of trade for most Latin American countries and the volume of their exports has expanded. A narrow range of products per country are exported to China; soybean seeds

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constitute 46% of Argentine exports to China, copper 42% of Chilean and 34% of Peruvian exports, and oil 89% of Ecuadorian exports (ECLAC, 2008).

China's recent investments in Latin America have been preceded by a vibrant and expanding trade relationship with many Latin American countries (see figure 1). The change in the trade relationship has been astounding. Trade between Latin America and China in 1999 totaled approximately $8 billion; in 2000, China's trade with Latin America totaled only $13 billion; coming to 2007 China's trade volume with Latin American countries skyrocketed to $103 billion; by 2010, it had grown 22 times and reached to approximately $180 billion. Chinese import volume amounted to $51 billion, a 49 percent increase from 2006. Export volume climbed to $52 billion, a rise of 43 percent over the previous year. In addition, during the same period, China signed a number of free trade agreements with countries in the region, including Chile, Peru and, most recently, Costa Rica.

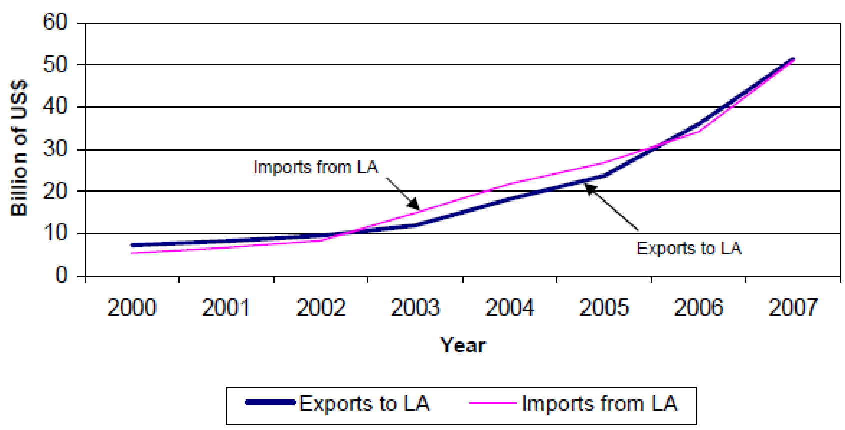

Figure 3-1 China's Trade with Latin America 2000 - 2007

Source: Chinese Ministry of Commerce: China Customs Statistic, 2008.

The trading relationship between China and Latin America has three mains facets: it is a buyer, seller and competitor. First, China is a huge buyer of raw materials from resource rich countries such as Argentina, Brazil, Chile, Ecuador and Venezuela. Second, China exports manufactured goods to almost every country in the region. Third, China competes in the region's export markets for manufactured goods, particularly, Central America and Mexico. As a result, China's trade relationship with resource rich countries in Latin America differs considerably from its relationship with those countries that depend primarily on the export of manufactured goods.

4. China direct investment

Chinese direct investment in Latin America is primarily of the ‚resource seeking' kind, particularly, oil and minerals. Geographically, this investment has gone mainly to Brazil, Chile, Peru and Venezuela (Funakushi and Loser, 2005: CEPAL, 2005). There has also been some Chinese investment in manufacturing in Mexico. The impact of Chinese investment in Latin America is confirmed by data on individual Latin American countries. Chinese government has encouraged investment in Latin America as a way to strengthen trade ties. Basically,

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most of the China's foreign direct investment (FDI) in natural resources is in Latin America, concentrated in 34 main projects in Argentina, Bolivia, Brazil, Chile, Peru, Ecuador, and Venezuela. Chinese FDI in Latin America increased from $226 million in 2003 to $22.7 billion in 2011 (see the table below). China's FDI tends to be in mining and infrastructure. It is China's large mining, oil and cement companies that are the most important players in China's overseas investment.

Country	1990-2009	2010	2011	2012
Argentina	143	5550	3530	600.00
Brazil	255	9563	9870	6 066.63
Colombia	1667	3	…	293
Costa Rica	13	5	700	…
Ecuador	1619	41	…	59
Guyana	1000	…	…	…
Mexico	127	5	…	…
Peru	2262	84	8640	829
Venezuela	240	900	…	…
Total	7336	16151	22740	7847.63

Table 4-1 China's FDI in some Latin American Countries

Sources: Economic Commission for Latin America and the Caribbean (ECLAC)

4 .1 Chinese investment features

4.1.1 Investment recipients

The greater part of direct investment from China has gone to natural resource enterprises (see figure 2), including hydrocarbons, copper and iron ore, and agriculture. It is not secret that the primary recipients of this investment have been those economies where natural resources are abundant like Peru, Argentina, and Brazil. In the meantime, China has been an important source of investment for smaller economies such as Guyana and Ecuador. Chinese investment has had very little significance in most of Central America countries and Mexico. The principal feature of Chinese investments is the willingness of Chinese government to make significant investments in economies that have been otherwise shunned by Western investors. For example, Venezuela has had a difficult time attracting foreign investors given the nationalization program instituted

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under Hugo Chavez regime and likewise Ecuador has been shut out of global markets since it defaulted on its bonds in 2006. Both countries have been significant recipients of Chinese investment including Cuba.

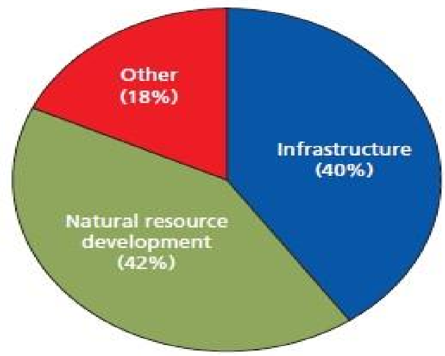

Figure 4-1 Total Chinese Investments by Category 2001 – 2011

4.1.2 Investment types

The type of these investments varies broadly, ranging from green-field projects to the purchase of exploration and production concessions specifically in the hydrocarbon sectors taking minority or control equity positions. In addition to these equity investments, Chinese banks have proven to be an important source of debt financing, both in assisting Chinese companies seeking to finance their overseas investments and in some other cases, lending directly to companies and sovereigns in Latin America.

4.1.3 Chinese investors

Almost all of Chinese investors making the headline grabbing deals are large state controlled enterprises in the natural resources sector. State controlled enterprises are evidently useful instruments for chinese government to implement state policy. The debt financing mentioned above offered to Chinese investors by Chinese state-owned banks for overseas expansion projects has been an important tool to promote expansion abroad and to internationalize China business.

A problem faced in providing a descriptive analysis on the impact of China investment in Latin America's development is availability of data and its quality. There are substantial discrepancies in trade statistics from different sources as well as reports of significant levels of contraband. In the case of FDI, there is a great paucity of data both on Chinese investment in Latin America and on flows in the opposite direction. So far, the researcher has considered the impact of China as a bilateral trade and investment partner for Latin America's development. However, because China is such a large economy, its emergence has impacts on world prices which also affect Latin America economies indirectly through changes in their terms of trade.

4.2 . Relationship between FDI and economic g rowth

This section provides a brief overview of studies on FDI in Latin American countries published between 2000 and 2010. Since the literature on FDI and economic growth is very wide, this period is chosen in order to

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present a summary of more recent trends on the subject. Though the topic of Chinese FDI's influence on Latin American countries growth and development will not be addressed empirically in this study, the growth literature is reviewed here in order to provide a broad and thorough background to the investigation of Latin America development under Chinese investment. In terms of the literature on the relationship between FDI and economic growth in developing countries, there is some disagreement between researchers with developing country cases. Some studies found evidence of a unidirectional relationship, others found evidence of a bi-directional relationship and a few found no evidence that FDI enhances growth in developing countries. The results are dependent on the sample used, the period covered and methods applied. Generally, the majority of research indicates that FDI does enhance economic growth in developing countries. This seems to be especially true for countries that have necessary absorptive capacities, such as, well-developed financial markets, sufficient levels of human capital and open trade regimes.

Looking at the impact of Chinese FDI in Latin America, the literature on the subject differs substantially from those on developing countries. Data restrictions make the analysis of FDI in Latin America especially problematic. In general, the literature seems to suggest that Latin America could benefit from FDI, especially if efforts are made to increase the continent's current level of human capital. The researcher also argues that Latin America should diversify its investment opportunities so that more FDI will be directed to the development of non-primary industries. In summary, available but fairly limited literature indicates that the important determinants of FDI to Latin America are economic growth, openness to trade, inflation, foreign reserves, quality institutions, good governance, literacy levels, levels of domestic investment and natural resource endowment. It must be noted that the sample taken, period covered and methods used in the relevant studies again differ substantially and these factors influence the outcomes.

4.3 Causality Test

The causality test between Chinese FDI and various other variables is provided. These causality tests don't mean to provide any in-depth insights into the dynamics between Chinese FDI and various Latin American countries performance variables, but instead, to clarify some issues which are controversial, and could most likely serve as a basis for future research and analysis.

4.3.1 The Causality between Chinese FDI and Latin American countries GDP

Granger causality tests were used in order to establish the relationship between Chinese FDI and important determining factors. The relationship between Chinese FDI and Latin American countries GDP was found to be bi-directional. Latin American countries with higher GDPs most likely attract larger amounts of Chinese FDI, at the same time; Chinese FDI enhances economic growth in Latin American countries.

4.3.2 The causality between Chinese FDI and Latin America corruption

A common perception of Chinese way of doing business is that corruption is the order of the day. Similarly, Latin American countries are well known for its corrupt regimes. Therefore, Chinese presence in Latin America may only entrench the corrupt business mentality. It is against this background that the causal relationship between corruption and Chinese FDI is interesting – do Chinese firms invest in Latin America

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because local corruption makes it easy for them to do so, or do Latin American officials become corrupt because Chinese firms enable them to? Granger causality test showed that Chinese investment in Latin America took place because corrupt practices here made it easy for Chinese firms to enter Latin American markets. However, the null hypothesis that Chinese FDI does not cause corruption could not be rejected at any level and implies that corrupted Chinese practices were not necessarily standing in the way of Latin America overcoming corruption.

4.3.3 The causality between Chinese FDI and Latin America infrastructure

With China's demonstrated interest in contributing toward Latin America infrastructure, the causal link between infrastructure and Chinese FDI is interesting to examine. Do high levels of Latin American infrastructure make investments attractive to Chinese firms, or does the presence of Chinese firms in Latin America enhance local infrastructure? Granger causality test shows that the latter was true. It was not Latin American countries infrastructure that attracted Chinese investment, but rather the absence of infrastructure that crowded Chinese FDI. The fact that Chinese investment contributed toward the region's infrastructure is positive. The most appealing trademark of FDI is that it should allow spillovers to take place. Granger causality test shows that Chinese FDI is contributing towards more infrastructure investment in Latin American region.

4.3.4 The causality between Chinese FDI and Latin American human capital

If Chinese FDI is to be beneficial to Latin American countries, then, the local population must be able to share in positive spillovers resulting from FDI. This includes access to technology, management skills and human capital. Ideally, local workers should learn from foreign investors and this should contribute toward Latin American human capital. To test for the causality between Chinese FDI and human capital, Granger test was conducted on Chinese FDI and gross secondary enrolment. The results showed that the relationship between these two variables was bi-directional, with human capital attracting FDI and FDI also leading to the development of human capital.

5. . Opportunities and challenges

The opportunities of Chinese investment for Latin American countries are versatile; vary from investment to investment, sector to sector and country to country. The main opportunities can be summarized as following:

5.1.1 Need for infrastructure investment

Latin American countries have an incredible list of infrastructure needs. While Brazil's preparations for the last World Cup and Olympic Games and pre-salt oil exploration grabbed headlines, throughout Latin America inadequate roads, ports, airports and energy grids are in serious need of upgrading. Without infrastructure upgrading, many Latin American countries will not be able to fulfill their economic potential. From 2011 to 2014, Brazil alone spent $750 billion on various infrastructure investments. The needs of infrastructure in Latin America are bigger than the money available from national sources. In the past, financing has come

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from a mixture of international banks, local banks and international development banks. Over the last decade, the local banking sector in Latin American countries have strengthened and deepened, providing an essential source of financing for local companies during the growth stage. However, the scale of infrastructure needs dwarfs what the local banks would be able to provide. Chinese financing sources can help fill the gap by providing a good impact in the development of the region.

5.1.2 Political and economic independence from United States and Europe

The latest financial crisis provides an excellent argument for diversifying financing sources on a philosophical and political level. Countries in Latin America are paying closer attention to chinese economic model given that China has been less affected by the global economic crisis than the United States and other leading capitalist countries in Europe. With increasingly strong democracies and economic gains, Latin American economies have become more self-confident with a view toward asserting their own diplomatic independence. In other words, countries which have elected left wing governments such as China are seeking a different status quo for ideological reasons, such as building ‚south south' alliances.

5.1.3 No strings attached policy

China has a policy of making investment decisions without considering a host country's domestic affairs, and this policy has given China an advantage over United States and European companies. Doing business with more controversial regimes around the globe is referred to as China's no strings attached policy. Though what seems certain is that stronger commercial ties result in stronger diplomatic relations. In the past decade, China has succeeded in building on its commercial ties and expanding and strengthening diplomatic relationships throughout Latin American countries, from the largest to the smallest economies, with both strong United State allies in the region such as; Colombia, Chile and those countries with more antagonistic views of Washington such as; Cuba, Ecuador, Nicaragua and Venezuela. Currently, the no strings attached investment policy of Chinese government certainly has attracted a number of Latin American countries, including those economies that do not have access to traditional Western market sources of financial capital.

5.1.4 China's long term view

Chinese government's involvement in many of its country's foreign investment decisions ensures that Chinese investments are motivated by stability over the long term, particularly, in energy and food security and it is not subject to the same pressures as investments from publicly traded companies from the United States and Europe whose shareholders usually demand immediate returns. Despite the fact that there might be some merit to this notion, whether Chinese government will in fact be a patient investor has not been tested by time. On the other hand, it seems that the next wave of investors in Latin America and Chinese private investors might face the same market demands as their Western counterparts.

The growing commercial relationship between China and Latin America is not without its challenges; the most important challenges can be summarized as:

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5.1.5 Challenges facing policy makers

China's political objective is to continue ‚The One China' policy which states diplomatic relations only with the Peoples Republic of China (PRC) and it requires any partner country to break official relations with the Republic of China (ROC or Taiwan). More than half of the countries located in Latin American continent still recognize the Republic of China (ROC or Taiwan). For example, in 2007, Costa Rica's recognition of PRC was followed by Chinese purchase of US$300 million Costa Rican bonds, $74 million worth investment in a football stadium construction and a free trade agreement in 2012. China offer similar packages with no hesitation for other countries in the region willing to switch and recognize ‚The One China' Policy. China has tried to foster good relations around the world to facilitate its smooth ascendancy for huge power status.

5.1.6 De-Industrialization

Enormous outflow of raw materials from Latin America and large inflow of manufactured goods from China compete against products manufactured domestically, thus, there is a big concern among policy makers in Latin America that commercial relationship with China will not lead to the long-term diversification of Latin American countries. For example, in 2002 just about 27% of Brazil's exports were raw materials, though by 2009 that figure had grown to 41%. The Brazilian trade deficit with China in manufactured goods has grown from several hundred million dollars a year to $23.5 billion in 2010. Policy makers are concerned that this imbalance in trade will hinder growth and lead to de-industrialization or in other words, decline of industrial activities in Latin America.

5.1.7 Foreign government control

Chinese companies closing blockbuster deals in the Latin America are by state-owned companies, therefore, there is a rising concern that large and valuable segments of Latin American countries are coming under the control of Chinese government. In addition, many countries in Latin America are worried with the concept of foreign ownership of land and mineral rights. A Brazilian court lately took a reportedly novel approach to interpreting an old law in order to prevent a transaction in the agricultural sector in which huge tracts of agricultural land would be turned over to a Chinese enterprise. New regulatory frameworks are being contemplated in Brazil that will restrict foreign ownership of strategic areas and minerals. Latin American governments worry that entire economies are becoming exaggeratedly dependent on China, for instance; Ecuador and Venezuela, which have much smaller economies than Brazil or other economies in the region, yet, have lately announced large investment deals with Chinese enterprises.

5.1.7 China as a competitor

Competition from Chinese imports is harming the manufacturing sectors of many Latin American economies and this image of China in Latin America is one that China must take care of. Mexico and certain Central American countries have experienced the hardest hit, particularly for competition in the U.S market where Mexico has lost its share of the textile market to Chinese competition. Brazil manufacturing sectors have been adversely affected in toy and shoe sectors. A primary cause suggested for this imbalance is that average

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salary in China is one-fifth to two-fifths of those in Latin America, thus, allowing considerably cheaper production and sale of Chinese goods. As a consequence of these concerns, Latin American countries have filed more than twice anti-dumping actions at the World Trade Organization than the United States or Western economies. Likewise, Brazil has increasingly sided with the United States over China's monetary policy, which keeps Chinese RMB at artificially low levels and greatly assists China in export markets.

5. 1. 8 Political and cultural challenges

Growing commercial ties with a non-democratic country like China undermine Latin America's own hard-won commitment to democracy. At least, for those economies in Latin America that are strong democracies, this fundamental difference in political and cultural systems would seemingly put a cap on relationship despite the fact how deep Chinese relationship with some countries can naturally progress.

6. Conclusions

China's investment in Latin America will continue because the mutual benefits outweigh the challenges by a significant margin. Chinese demand for raw materials has been lucrative for many Latin American countries. Financial capital in Latin America, mainly in the case of infrastructure investment, is sorely needed. The heavy involvement of Chinese state-owned enterprises, significant investment already made and the material efforts of Chinese government to expand commercial and diplomatic relationships in the region suggest that Chinese interest in the Latin America will continue for some time. The first wave of Chinese investment in region characterized by large blockbuster deals by Chinese state-owned enterprises has paved the way for the second wave of investment, which will likely include more activity by private Chinese enterprises and will have great impact as the first wave of investments did.

China's investment in infrastructure and manufacturing sectors will increase, while natural resource transactions will continue to be a staple of future Chinese-Latin American trade and investment. It seems that the second wave of Chinese investment will be characterized by the increasing role of Chinese companies involved in infrastructure, manufacturing and other sectors. In the infrastructure sector, the investments appear to be neatly aligned with the needs of many Latin American countries, and it would appear to serve Chinese image in Latin America. And, it will be part of the story of Latin America's development. Given the increasingly important role Chinese companies play in infrastructure development in the region, Chinese banks will follow offering financing for projects. Less certain is whether Chinese banks will leverage this activity to provide capital for Latin American corporate borrowers; however it will be interesting to see how the role of Chinese banks develops. So far, Chinese banks have been fairly quiet in the region.

China's diplomacy in Latin America has so far been a natural outgrowth of its trade and investment ties. As a result, over the last decade these ties have on balance contributed to economic growth and development of Latin America and are part of the collective story of region successes. This prosperity results in additional contribution to this virtuous cycle of prosperity and stability in the region. In brief, the challenge to Latin America countries will be one of sustainable development of balancing its lucrative trade in raw materials while protecting its local manufacturing sector and developing its infrastructure. China's challenge will be to

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secure its raw material sources while maintaining a positive image in the region. To do so, China will need to carefully consider its export policies, especially in the manufacturing sector.

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